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CIA Chief Testifies in U.S. Tax Court About Deductions Challenged by IRS

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NEW YORK, June 29—CIA Director William J. Casey spent part of today far from his usual world of monitoring the KGB and overseeing covert actions in Central America.

For more than an hour, he was on the witness stand in U.S. Tax Court here, being cross-examined by an Internal Revenue Service attorney who wanted to know how he arrived at a $5 million sales price for a patent for a tri-rotor engine in 1976.

A few months earlier, Casey had paid $10,400 for his 30 percent interest in the still-to-be perfected device.

The value of the engine, which Casey said has been "temporarily dismantled" to correct deficiencies, is at the center of a dispute between the IRS and a partnership formed by a longtime friend and business associate of Casey, Carl Paffendorf of Long Island.

The IRS disallowed all $5.5 million in losses that the Tri-Rotor Motor Co. partners took between 1977 and 1980, claiming that "the alleged purchase price of the patent" and the accompanying promissory note "unreasonably exceeded the fair market value of the patents at the time of the purchase."

The agency said the purchase and claimed research expenditures "were solely or primarily to reduce the income taxes of the partners."

The IRS has rejected claims of millions of dollars in losses from other Paffendorf-organized partnerships.

Casey is not a member of the Tri-Rotor partnership and did not share in the deductions disputed in today's case. But he is a limited partner in two other Paffendorf-sponsored ventures, and is facing an IRS claim that he owes at least $100,000 in back taxes, [illegible] deductions.

WILLIAM J. CASEY
... sales price of patent is central issue

In one instance, he invested $95 and took deductions of about $60,000 over four years.

Casey, 71, is a millionaire tax lawyer and businessman whose personal finances have been a matter of controversy ever since his first presidential appointment as chairman of the Securities and Exchange Commission in 1971. He has a reputation for investing in high-risk ventures.

He testified today that he bought into the tri-rotor engine venture because he knew the inventor and thought the engine might improve fuel efficiency at a time of huge increases in oil prices.

Casey told IRS lawyer Alan H. Kaufman that the $5 million price for the patent "evolved" from discussions he had with Paffendorf. He said he wanted to set a price to "represent the value of the potential we thought this development had."

Only $50,000 of the selling price was paid in cash at the time, with the remaining $4.95 million held in the form of a "non-recourse" note secured by the patent.

Casey said he was more interested in getting money to develop the engine than in collecting on the note, and thus deferred his interest payments, which would have amounted to about $90,000 a year. He said he has received $60,000 in payments in the eight years since he sold the patent.

He acknowledged that he probably valued his interest in the patent incorrectly on his federal financial disclosure forms. He reported his 30 percent share at the $10,400 it cost him, but not the $1.5 million share of the promissory note owed him by the engine company partners.

Casey's cross-examination also sparked moments of anger and humor. At one point, he disputed Kaufman's reference to a Paffendorf company as being "in the business of selling of tax deductions."

"I would like to take exception to any notion that I purchased a tax deduction," Casey said. He said he made investments based on economic merit. "I purchased their future .... But to say I purchased tax deductions is an outrageous distortion."

At another point he drew a chuckle from the audience when he said that in 1952 he wrote the first book on tax shelters.

"I started the whole thing," he said with a smile. "When I became chairman of the SEC, I redeemed my sins."

Special correspondent John Kennedy contributed to this report.